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News

California Debt Ratings Removed from CreditWatch

Analyst: David G Hitchcock, New York (1) 212-438-2022; Steven G Zimmermann, San Francisco (1) 415-371-5004;
Alexander M Fraser, Dallas (1) 214-871-1406

NEW YORK (Standard & Poor's CreditWire) June 28, 2001 – Standard & Poor's today removed the state of California's GO and lease ratings, as well as those ratings for the California Health Facilities Construction Loan Insurance Fund (Cal Mortgage) that are secured by the full faith and credit of the state, from CreditWatch, where they were placed with negative implications on Jan. 19. In addition, Standard & Poor's affirmed the state's GO bond rating at single-'A'-plus and the state's lease debt at single-'A'. The long term rating outlook remains negative.

The removal of the ratings from CreditWatch reflects the alleviation, at least for the time being, of liquidity pressure on California's general fund, following the recent closing of a \$4.3 billion interim loan facility with J.P. Morgan Securities Inc., Lehman Brothers, and other financial institutions for future purchases of electric power through the state's Department of Water Resources.

The maintenance of the single-'A'-plus GO rating, but with a negative rating outlook, reflects the state's continued rapid level of spending for power purchases; the only thing that has changed is that it is using borrowed money instead of its own. The interim loan facility buys the general fund time to find a satisfactory workout situation.

The amount of the interim loan facility could potentially rise--the Governor has authorized by proclamation interim financing of up to \$5 billion, and could conceivably raise the amount further. The loan facility will stanch the immediate cash drain on the state's general fund. However, the interim loan facility is not intended to repay the general fund for electrical purchases already made. The state has bought more than \$6 billion of power so far this year, essentially depleting the general fund.

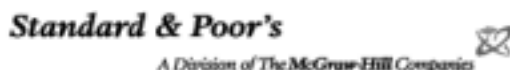
The governor's proposed budget for the fiscal year ending June 30, 2002 substantially draws down the state's general fund accumulated fund balance by approximately \$4.8 billion (6.1% of expenditures), while also assuming the replenishment of the general fund for power purchases already made. Thus, an inability to sell the proposed refinancing revenue bonds, or a substantial delay, would create a large general fund deficit.

Proceeds from an anticipated \$13 billion revenue bond offering later this year are intended to replenish the general fund for those purchases and to refinance the interim loan, as well as fund future power purchases. However, several hurdles may need to be resolved before the successful sale of these revenue bonds is accomplished, including legal issues surrounding the bankruptcy of Pacific Gas & Electric and a negotiated rate agreement with the California Public Utilities Commission, among other matters. Should a successful revenue bond sale occur, the state general fund balance should be restored, but the state's economy may be affected for years to come as electric ratepayers pay higher rates, and it does not remain out of the question that the general fund may be utilized for future power purchases should the

proceeds of the revenue bond offering prove insufficient to fully fund power purchase shortfalls before new generating plants are projected to significantly lower the cost of power by late 2002. Recently, wholesale electric prices have declined sharply due to favorable weather and as existing generators have come back on line after completion of scheduled maintenance. This has reduced, but not eliminated, the state's cost of purchasing power. Conversely, a sustained heat wave or significant unforced outage could potentially cause wholesale power prices to rise again.

Since the loan will not be reimbursing the general fund, the general fund's cash position will remain low. An earlier state general fund cash flow projection anticipated only \$483 million of cash (0.6% of cash expenditures) at the end of June 2001, after \$6.2 billion of cash payments for power purchases during fiscal year 2001. However, the state still projects other internally borrowable funds of about \$10 billion throughout fiscal 2002, indicating adequate resources to maintain operations should the revenue bond be temporarily delayed, Standard & Poor's said. -- CreditWire

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